



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201315027**

Release Date: 4/12/2013

Date: January 16, 2013

UIL 501.03-00

Contact Person:

Identification Number:

Contact Number:

(*) (*)-*

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Dear

This is our final determination that you do not qualify for exemption from federal income tax as an organization described in Internal Revenue Code § 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law, and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in § 501(c)(3), donors may not deduct contributions to you under § 170. You must file federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under § 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at

1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Holly O. Paz
Director, Rulings and Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: November 16, 2012

UIL 501.03-00, 501.03-30

Contact Person:

Identification Number:

Contact Number:

(**) **-****

FAX Number:

(**) **-****

Employer Identification Number:

Legend:

<u>State</u>	=	*****
<u>Date1</u>	=	*****
<u>Corporation1</u>	=	*****
<u>Corporation2</u>	=	*****
<u>LLC</u>	=	*****
<u>Date2</u>	=	*****

Dear

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code § 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under § 501(c)(3). The basis for our conclusion is set forth below.

Facts:

You were incorporated under the laws of State on Date1. Your Articles of Incorporation state that you are organized for charitable, religious, educational, and scientific purposes within the meaning of § 501(c)(3). Your specific purposes include acting as an administrative services organization to provide management and other support services that promote, support, and benefit organizations qualifying under § 501(c)(3), including, without limitation, Corporation1 and Corporation2, hereafter referred to as the Initial Members, collectively. The Initial Members are unrelated to one another. Additional § 501(c)(3) organizations may become members only upon the unanimous approval of the Initial Members and must meet the qualifications set forth in your Bylaws. Your Articles contain a prohibition on inurement and provide that upon dissolution all remaining assets shall be distributed to your members provided that each is then qualified as an organization under § 501(c)(3).

A predecessor organization, LLC, was formed on Date2 but never operated. As the process of making LLC operational moved forward, it was determined that a limited liability company was not the best form for facilitating the contemplated purposes. As a result, a Plan of Merger was

adopted, you were incorporated, and the merger took immediate effect on Date1—your date of incorporation.

The information provided in Form 1023 indicates you were designed to provide your Initial Members and other area tax-exempt organizations desiring to use your services the benefit of collaborating and sharing a variety of management and related administrative services, thereby gaining efficiencies and economies of scale and allowing the participating organizations to focus on their respective missions, goals and programs. Specific services contemplated include four core service areas: human resources; finance/accounting and electronic health record development/management; information technology; and support services. In particular:

- The Finance Department will provide: financial reporting; development of management tools; monthly reconciliation of general ledger accounts; payroll processing; accounts payable; billing for reimbursements; internal budgets and budgets for grant proposals; contract negotiation and the setting of reimbursement rates; review of fiscal policies and procedures and monitoring of internal controls; oversight of annual audits and site visits from funders, coordination of tax reporting; procurement of insurance including property insurance, professional/general liability, workers compensation, and D&O; and treasury functions and management of cash flow.
- The Human Resources & Training Departments will provide centralized services for all human resource needs including: recruitment; applicant tracking and processing; benefit management & tracking; employee documentation; time and labor tracking; payroll processing; HR consultation; employee training; and training management and maintenance.
- The EHR Development/Management Department will provide: maintenance of clinical records; EHR implementation and maintenance; report customization; ad hoc reporting; assigning caseloads, access and permissions; forms customization and creation of new forms; producing required reports; providing user support for medical records; responding to ROIs; assistance during audits; and claims based billing.
- The Information Technology Department will: support the infrastructure of advanced communications, data storing and data sharing technology; support fiber and broadband computer networks; provide professionals to ensure system security, network administration, database management and software and hardware support; provide a one-stop Helpdesk support system; provide continuing professional development to IT staff; the goal to utilize advances in technology to reduce costs and increase productivity, security and outcomes.
- The Property Management/Transportation/Purchasing Department includes: the Maintenance Department providing HVAC; plumbing; painting; repair work; light electrical work; locksmith and other services to be determined: the Transportation Department overseeing a combined fleet of 60+ vehicles and providing fleet maintenance; recordkeeping; coordination of trips and funder documentation: and the Purchasing Department using the combined purchasing power of the members to

aggressively negotiate to obtain the most favorable pricing.

To implement your activities, you state you will enter into two different contracts with each of your Initial Members. The first contract will be a management services agreement pursuant to which each member will purchase certain management services. Secondly, you will enter into employee leasing agreements with your Initial Members to lease employees from each member to conduct your operations. Until your operations become firmly established, the amount to be paid by the Initial Members under the management services agreement will, in the aggregate, equal the amounts to be paid to each of the members under the employee leasing agreements. You expect that cost efficiencies generated over time will allow excess income to be passed back to the members.

You further state that all services you will provide to the Initial Members would be carried on directly by them in the absence of your management services agreements. At the time of your application, you had not expanded services to other organizations. However, you indicated that contracts with other § 501(c)(3) organizations will be negotiated such that payments are calculated and paid either at the cost of the goods or services provided, or at cost plus a reasonable administrative fee.

You will not engage in fundraising. You state that your sole source of revenue once you are fully operational will come from gross receipts. Gross receipts are categorized as follows:

- In-kind Occupancy Costs: rent, including utilities and building maintenance costs, which will be donated by Corporation2 for the space the space you occupy.
 - Rent will be charged based on square footage at fair market value; you will use an analysis of similar space in the local real estate market.
- Administrative Services: revenue relating to services provided for finance/accounting, human resources, electronic health record development/management, information technology, and support services.
 - Fees will be charged based on cost plus an administrative fee.
- Property Maintenance Services: revenue relating to service provided for property maintenance—repairs, renovations, project management, etc.
 - Fees will be charged at \$ per hour which is based on cost plus a small administrative fee.

You state that all fees are based on cost plus an administrative fee not to exceed the fair market value. All fee schedules are approved by your board of directors.

Your expenses include those for occupancy; depreciation and depletion; professional fees; and disbursements to or for the benefit of members (i.e., employee leasing costs). You list computer software and leasehold improvements as your depreciable assets. You also list expenses for software maintenance fees; software subscription fees; insurance; operating expenses; and bank fees. You explain that operating expenses are for office supplies such as stationary, envelopes, postage, computer supplies, website maintenance, and meeting costs.

Your Bylaws provide that you shall have not less than three and not more than eleven directors. All directors shall be elected by majority vote of Initial Members. Directors shall not receive compensation for their services. You listed six members on your Board.

- President/CEO: also President/CEO of Corporation1 and receives compensation from Corporation1; will have primary management responsibility over you; will spend % of working time on your matters. You have agreed to reimburse Corporation1 for % of compensation.
- Treasurer: also serves as COO of Corporation1 and receives compensation from Corporation1.
- Secretary: also serves as Chairman of the Board of Corporation1.
- Chairman of the Board: also serves as the Chairman of Corporation2.
- Director1: also serves as President/CEO of Corporation2 and receives compensation from Corporation2.
- Director2: also serves as COO of Corporation2 and receives compensation from Corporation2.

Each member has one vote on all matters coming before the members for action. Your Bylaws do not contain any provision on membership qualifications other than naming the Initial Members as such. You have adopted a Conflict of Interest Policy.

Law:

Section 501(a) provides that an organization described in subsection (c) is exempt from income taxation.

Section 501(c)(3) provides for the exemption from federal income tax of organizations that are organized and operated exclusively for charitable, scientific or educational purposes, or for the prevention of cruelty to children, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that, in order to be exempt as an organization described in § 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in § 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(e)(1) provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying

on an unrelated trade or business (as defined in § 513). In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes.

Rev. Rul. 54-305, 1954-2 C.B. 127, concerns an organization whose purposes are to secure for hospitals and other charitable institutions the advantages of cooperation in establishing uniform standards as to quality and kind of supplies and the purchasing of the same, and to promote the economical and efficient administration of hospitals and other institution and to establish and maintain a central purchasing agency. Any hospital or similar institution not conducted for profit and engaged in charitable work is eligible for membership. The organization's income is derived from dues, cash discounts on purchases for members, and service charges. The ruling states that the activities of the organization – the purchase of supplies and the performance of related services for the several otherwise unrelated charitable organizations that constitute its membership – cannot be termed charitable, but are ordinary business activities. The ruling holds that a corporation organized and operated for the primary purpose of operating and maintaining a purchasing agency for the benefit of otherwise unrelated members who are exempt from federal income tax as charitable organizations is engaged in business activities which would be unrelated activities if carried on by any one of the tax-exempt organizations served. Therefore, the organization is not entitled to exemption under § 101 (the precursor of § 501(c)(3)).

Rev. Rul. 69-528, 1969-2 C.B. 127, concerns an organization formed to provide investment services for a fee exclusively to organizations exempt under § 501(c)(3). The ruling states that providing investment services on a regular basis for a fee is a trade or business ordinarily carried on for profit. If the services were regularly provided by one tax-exempt organization for other tax-exempt organizations, such activity would constitute unrelated trade or business. Thus, the ruling holds that the organization is not described in § 501(c)(3) since it is regularly carrying on the business of providing investment services that would be unrelated trade or business if carried on by any of the tax-exempt organization on whose behalf it operates.

Rev. Rul. 71-529, 1971-2 C.B. 234, concerns an organization formed specifically to assist § 501(c)(3) organizations to manage more effectively their endowment or investment funds. Membership in the organization is restricted to colleges and universities exempt under § 501(c)(3). Its board of directors is composed of representatives of the member organizations. Most of the operating expenses of the organization are paid for by grants from independent charitable organizations. The member organizations pay only a nominal fee for the services performed. These fees represent less than fifteen percent of the total costs of operation. The ruling states that, by providing the services described above to its members, the organization is performing an essential function for charitable organizations. By performing this function for the organizations for a charge that is substantially below cost, the organization is performing a charitable activity within the meaning of § 501(c)(3). Consequently, the ruling holds that the organization qualifies for exemption under § 501(c)(3).

Rev. Rul. 72-369, 1972-2 C.B. 245, concerns an organization formed to provide managerial and consulting services for nonprofit organizations exempt under § 501(c)(3) to improve the administration of their charitable programs. The organization enters into

agreements with unrelated nonprofit organizations to furnish managerial and consulting services on a cost basis. The ruling states that the provision of managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services in this case are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of section 501(c)(3) of the Code. Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable. Accordingly, the ruling holds that the organization's activities are not charitable and, therefore, the organization does not qualify for exemption under § 501(c)(3).

Analysis:

You were formed as an administrative services organization to provide management and support services to organizations describe in § 501(c)(3). Corporation1 and Corporation2 are your Initial Members who, aside from their common membership in you, are unrelated. You will enter into a management services agreement with each Initial Member under which the member will purchase certain management services in the areas of human resources, finance and accounting, information technology, and other support services, thereby enabling those Initial Members to realize efficiencies and economies of scale. Fees for such services will be based on cost plus an administrative fee

Section 1.501(c)(3)-1(e) infers that an organization that is organized and operated for the primary purpose of carrying on an unrelated trade or business does not meet the requirements of § 501(c)(3). This principle is illustrated in Rev. Rul. 54-305, which stands for the proposition that purchasing and related administrative support services that promote the economic and efficient administration of charitable organizations are not charitable activities, but ordinary business activities. If a charitable organization were to provide such services to other unrelated charitable organizations, such activities would be considered an unrelated trade or business of the provider. Thus an organization engaged solely in such activities would be deemed organized and operated for the primary purpose of carrying on an unrelated trade or business, and, consequently, would fail to meet the requirements of § 501(c)(3).

Correspondingly, if Corporation1 were to provide administrative services to Corporation2 for a fee, such activities would constitute an unrelated trade or business of Corporation1. Because the provision of administrative services to your Initial Members and other unrelated charitable organizations is your sole purpose and activity, we conclude that you are organized and operated for the primary purpose of carrying on an unrelated trade or business, and do not qualify for exemption under § 501(c)(3).

Our conclusion is buttressed by Rev. Rul. 69-528, in which it was held that if a tax-exempt organization provides investment services for a fee to another unrelated tax-exempt organization, such activity would constitute an unrelated trade or business. Thus, it was reasoned that an organization formed for the sole purpose of providing such services is not described in § 501(c)(3) because it is organized and operated for the primary purpose of carrying on an unrelated trade or business.

Like investment services, the services you provide can be obtained from for-profit commercial businesses. The provision of commercially-available services to unrelated exempt organizations at cost is not a basis for exemption under § 501(c)(3). This proposition is illustrated by comparing Rev. Rul. 71-529 with Rev. Rul. 72-369.

In Rev. Rul. 71-529, an organization formed to provide investment services to unrelated colleges and universities was found to be engaging in charitable activities because the fees paid by its members for such services were nominal (less than 15 percent of the total costs of operations). By comparison, in Rev. Rul. 72-369, an organization formed to provide managerial and consulting services at cost to exempt organizations for the purpose of improving the administration of their charitable programs was found to be carrying on a regular commercial trade or business. It was concluded that the organization does not qualify for exemption under § 501(c)(3) because the furnishing of commercially-available services at cost is insufficient to establish the activity as charitable.

You will provide commercially-available services to other unrelated § 501(c)(3) organizations either at cost or at cost plus a reasonable administrative fee. Thus, your activities, like those of the organization described in Rev. Rul. 72-369, are not charitable.

Accordingly, you do not qualify for exemption as an organization described in § 501(c)(3) and you must file federal income tax returns. Contributions to you are not deductible under § 170.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Service will consider the failure to protest as a failure to exhaust available administrative remedies. Section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of

Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the Service.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to this address:

Internal Revenue Service
TE/GE SE:T:EO:RA:T:1

1111 Constitution Ave, N.W.
Washington, DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Holly O. Paz
Director, Rulings and Agreements